

Effectiveness of Tax Deduction at Source (TDS) in India

B.AMARNATH

DEPARTMENT OF MBA

MALLA REDDY UNIVERSITY, HYDERABAD

I.Abstract:

To Study and analyses all the purposes for which TDS in India was introduced to ensure whether they are properly achieved for collection of more revenues to Govt. Also study major types of tax system in the world. Study whether Adam smith's all the four Canon of Taxation are satisfied by TDS mechanism and to what extent with reasons there for. To conclude, considering major tax collection mechanism, whether TDS mechanism is effective or not.

II.Introduction:

The purpose of introduction of Tax Deduction at Source is

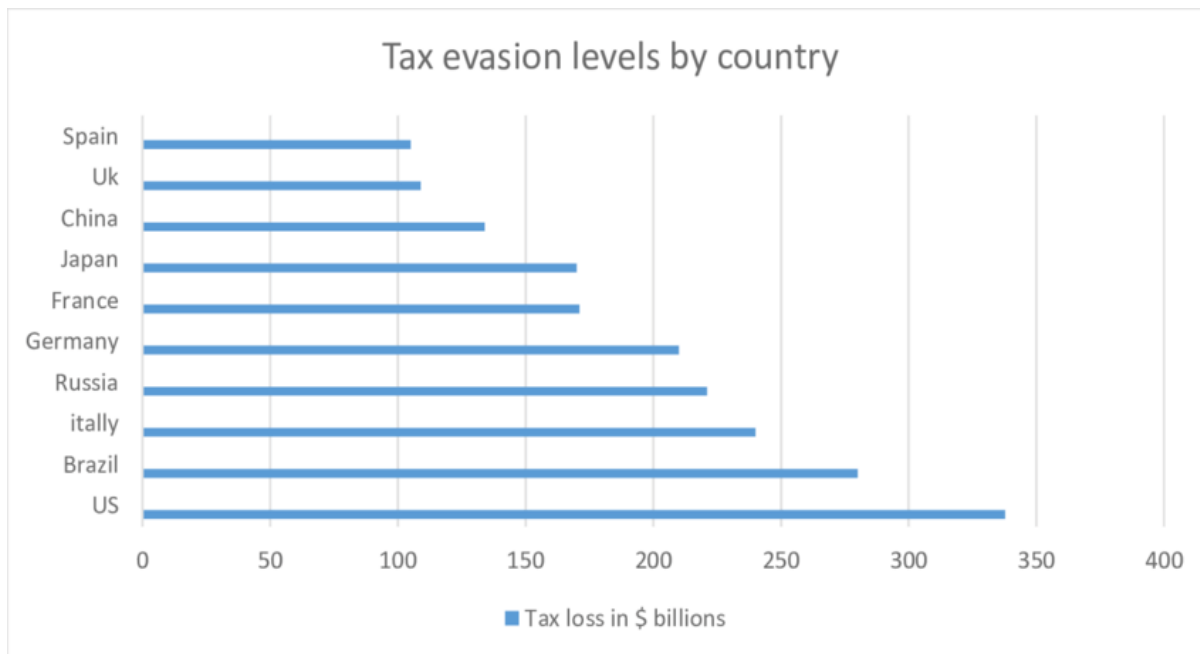
- (1) To prevent Tax Evasion
- (2) Widen the assessee base
- (3) Regular flow of Tax revenue

1) To prevent Tax Evasion: The purpose of the introduction of Tax Deduction at Source (TDS) is primarily to prevent tax evasion. TDS is a mechanism implemented by the government to ensure that taxes are deducted at the source of income itself. It requires certain individuals or entities making specified payments to deduct a certain percentage of tax before making the payment. This deduction is then remitted to the government on behalf of the recipient.

By implementing TDS, the government aims to address the issue of tax evasion by ensuring that a portion of the income is deducted and remitted to the government upfront. This helps in curbing tax evasion as it reduces the possibility of individuals or entities evading their tax liabilities. It acts as a preventive measure by ensuring that tax is collected at the source of income, thereby minimizing the scope for underreporting or non-reporting of income.

TDS also acts as a deterrent to tax evasion by creating a sense of responsibility among taxpayers. It instills a culture of compliance and encourages individuals and entities to accurately disclose their income and pay the appropriate taxes. By implementing TDS, the government can track the flow of income and identify potential discrepancies or attempts to evade taxes.

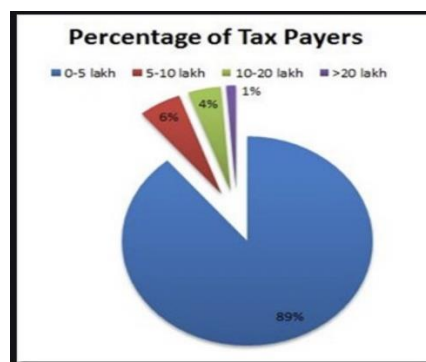
Overall, the introduction of TDS is a significant step towards preventing tax evasion by ensuring that taxes are deducted and remitted at the source of income, thereby promoting transparency, fairness, and compliance in the tax system.



2) Widen the assessee base: Another purpose of the introduction of Tax Deduction at Source (TDS) is to widen the assessee base.

By implementing TDS, the government can bring a larger number of taxpayers under the tax net. When taxes are deducted at the source of income, it ensures that even individuals or entities who may not otherwise be diligent in filing their tax returns are included in the tax system. TDS applies to various types of payments, such as salaries, interest, rent, contractor payments, etc., thereby expanding the assessee base by covering a wide range of income sources.

By widening the assessee base through TDS, the government aims to ensure that a larger segment of the population contributes to tax revenue. This leads to a fairer distribution of the tax burden and reduces the burden on a smaller subset of taxpayers. It helps in achieving a more equitable and inclusive tax system by bringing more individuals and entities into the tax net, thereby promoting tax compliance and revenue generation.



3) Regular flow of Tax revenue: TDS helps in achieving a regular and consistent flow of tax revenue to the government. By deducting taxes at the source of income, the government ensures that a portion of the tax liability is collected upfront. This helps in avoiding delays or potential defaults in tax payment by taxpayers. TDS covers various types of payments, such as salaries, interest, dividends, contractor payments, etc., ensuring that taxes are collected in a timely manner.

The regular flow of tax revenue is crucial for the government to meet its expenditure commitments and carry out various developmental activities. By implementing TDS, the government can mitigate the risk of tax evasion and ensure a steady influx of tax revenue throughout the financial year. This improves the financial stability and fiscal management of the government, allowing it to plan and allocate resources effectively.

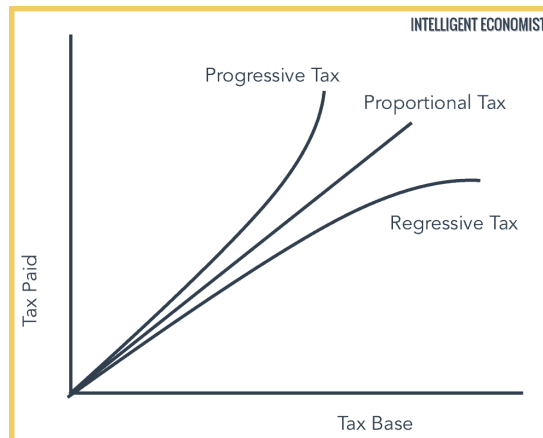
In summary, one of the purposes of TDS is to ensure a regular flow of tax revenue, which is essential for the government's functioning and meeting its financial obligations.

III. THREE TYPES OF TAX SYSTEMS:

1. Progressive Tax System: In a progressive tax rate system, higher income individuals pay a higher proportion of tax with a rise in income. In this case, the marginal tax rate would be higher than the average tax rate. A progressive tax is cited as a method to reduce inequality in society. Most economies around the world use a progressive tax to assess taxes for individual income.

2. Proportional Tax System: In a proportional tax rate system, everyone pays the same proportion of his or her income as tax. The tax rate does not change with an increase or decrease in income. Here, the average tax rate is equal to the marginal tax rate. This system exists in Latvia and Russia, and is considered to be more „fair“ and easier to manage for everyone. Some states in the U.S. like Colorado, Utah and Michigan impose a proportional income tax for individuals.

3. Regressive Tax System: A regressive tax is a tax which results in a decrease in the tax rate as the amount subject to taxation increases. In a regressive tax rate system, the individuals with lower income pay a higher proportion of his or her income as tax. Here, the marginal tax rate is lower than the average tax rate. Any tax with a cap above which no taxes are paid are regressive taxes.



Whether Indian TDS mechanism Satisfies Principles or canons of Taxation?

- 1) Equality
- 2) Certainty
- 3) Convenience
- 4) Economy Equality

1) Equality: The first canon or principle of a good tax system emphasized by Adam Smith is of equality. According to the canon of equality, every person should pay to the Government according to his ability to pay. However, modern economists interpret equality or ability to pay differently from Adam Smith that is progressive income tax, that is, the rate of tax increases as income rises. But, TDS rates are flat percentage from 1 % to 30 % depending upon the nature of transaction irrespective of the volume of income on which TDS is deducted.

%	Sec.	Nature of transaction
1	194D 194IA	Payment to LIC, Transfer of Immovable property
2	194 I	Rent of Plant & Machinery
5	194 D 194 G 194IB 194LD	Payment of Insurance premium Comm. On sale of lottery tickets Rent Interest on few Bonds & Govt securities
10	193 194, 194A	Interest on securities & debentures Dividend, Interest on other than securities, etc.,
20	194F	Repurchase of units of Mutual funds
30	194B 194BB	Winning from lottery/puzzle//game Winning from horse race

Hence, TDS does not satisfy cannon of Equality.

2) Certainty: The tax which each individual is bound to pay ought to be certain and not arbitrary. The time of payment, the manner of payment, the quantity to be paid ought all to be clear and plain to the contributor and to every other person.

Sometime, applicability of TDS may not clear. This question arises when there is a conflict with respect to a particular transaction falls under “contract for sale” or “contract for work/service”. Contract for sale involves transfer of property in goods for consideration for which TDS provisions are not applicable. In contrast Contract for work/service involves adding some value to the property by doing some workmanship or performance of an express task or service and is subject to TD.

Some of the peculiar examples are presented:

Nature of Transaction	Applicability of TDS
Subscription to Journals	No
Advertisement in Journals	Yes
Membership fee to certain organizations	No
Training fee	Yes
Software procured in CD form	No
Payment for customized software	Yes

Next one is identification of appropriate TDS section to know rate of TDS, it depends upon so many factors like- Nature of work or routine or normal, composite contract or different, deductor is resident Indian or nonresident, corporate or non-corporate, eligible for no deduction/nil deduction etc. TDS does not fully satisfy this principle because many cases whether TDS is applicable to particular person and/or which rate applicable are not clear. To some extent, lack of clarity in respect of applicability TDS to particular person and also applicable rates.

3) Convenience: According to the third canon of Adam Smith, sum of tax, time and/manner of payment of a tax should not only be certain but the time and manner of its payment should also be convenient to the contributor. For TDS these are certain, but payment is not convenient to all detectors especially to small detectors.

4) Economic Equality: If the collection costs of a tax are more than the total revenue yielded by it, it is not worthwhile to levy it. But in TDS mechanism, tax collection, remittance, filing of returns, issue of certificates all are done by assesses only on behalf of Govt., cost of collection of TDS is very low, however those detectors of TDS are suffering a lot due to lack of clarity and simplicity in TDS collection, remittance and filing rules/procedure.

Therefore, even for achieving economy in the tax collection, the tax rules must be as much simple as possible and TDS detectors who doing on behalf of Govt. should not be suffered.

IV) Conclusion:

- ❖ All purposes for which TDS was introduced are not fulfilled

Purpose of TDS	Status of fulfillment
1.Prevent Tax evasion	Not fulfilled
2.Widen the assessee base	Not fulfilled
3. Regular flow of tax revenue.	To some extent fulfilled

- ❖ TDS mechanism does not satisfy all the canon of taxation.

Canon of Taxation	Status of TDS
1.Equality	Not satisfied
2.Certainty	Not satisfied
3.Convenience	To some extent satisfied
4.Economy	Not satisfied

❖ Therefore, total Direct Tax collections for the year 2021-22 (up to Dec-18) is ₹8.74lakhs Crores which is 14.1% higher than the Budget Estimate for the Financial year 2021-22. TDS contributes nearly 42% (Rs. 3.69Lakhs Crores) to the gross direct taxes collections that emphasizes its ever growing importance in the total volume of direct taxes collection in the country.

❖ The purpose of introduction of TDS is good, but, it is not effective Hence, Certain modifications in the TDS mechanism and procedures may be done to enable the TDS to become an effective and smooth one.

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